

**WILLIAM R. SLOAN**

*Attorney at Law*

199 IVY BROOK DRIVE  
BETHPAGE, TN 37022

TELEPHONE: (615) 888-2679  
FAX: (615) 888-2679

REC'D TN

REGULATORY AUTH.

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EXECUTIVE SECRETARY

July 6, 1998

Mr. David Waddell, Executive Secretary  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37248

RE: Docket No. 98-00021, American Association of Retired Persons  
Petition for an Investigation and/or Show Cause Order of the Just  
and Reasonableness of the Rates of BellSouth Telecommunications, Inc.

Dear Mr. Waddell:

Enclosed are the original and thirteen copies of American Association of Retired  
Persons amended and supplemental petition.

Sincerely,

  
William R. Sloan

**BEFORE THE TENNESSEE REGULATORY AUTHORITY  
NASHVILLE, TENNESSEE**

**IN RE: Petition for an Investigation and/or Show Cause Order  
To Determine Just and Reasonable Rates Charged By BellSouth  
Telecommunications, Inc.**

**Docket No. 98-00021**

EXECUTIVE SECRETARY

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**AMENDED AND SUPPLEMENTAL PETITION OF  
AMERICAN ASSOCIATION OF RETIRED PERSONS**

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The American Association of Retired Persons ("AARP") files this amended and supplemental petition and respectfully moves that the TRA enter an order requiring BellSouth Telecommunications, Inc. ("BellSouth") to show cause why the TRA should not conduct an investigation as to BellSouth's earnings for the period from January 1, 1996 until the effective date of a price regulation plan for BellSouth, determine a reasonable rate of return and a level of just and reasonable rates for BellSouth during that period, and enter an order fixing BellSouth's rates prospectively for the remainder of that period, requiring an appropriate mechanism for the sharing with its customers of its excessive earnings; or in the alternative, treat the original petition as hereby amended and supplemented as a complaint and set the matter for hearing at an early date, designate a hearing officer to hold a pre-hearing conference for the purpose of defining the issues, setting a schedule for the filing of pre-filed testimony and briefs and making recommendations for the disposition of any preliminary matters; and for grounds AARP states as follows:

### THE STATUS OF THE PROCEEDING

1. On January 13, 1998, AARP filed its original petition in this matter alleging that BellSouth's rates charged its Tennessee customers had been unjust, unreasonable and excessive during the period from January 1, 1996 through the first nine months of 1997 (the most recent figures then available), and that as a result BellSouth had collected from its Tennessee customers excessive earnings totaling for that period \$285 million dollars and that on a going forward basis rates would continue to be unjust, unreasonable and excessive by more than \$200 million a year.

AARP, therefore, asked that the TRA protect Tennessee consumers by exercising its powers under the general statutes governing its regulation of companies such as BellSouth by setting just and reasonable rates for BellSouth.

2. BellSouth filed a motion to dismiss the petition on the grounds that for the TRA to conduct an earnings investigation with respect to BellSouth's rates would be contrary to the orders entered by the Tennessee Court of Appeals; that BellSouth was seeking a price regulation plan, which the TRA was required to approve; and that its rates were just, reasonable and affordable.

3. The matter was heard on oral argument by the TRA at its regular conference on June 5, 1998, at which time the decision was made to hold the matter in abeyance until the Tennessee Supreme Court acted on the Application for Permission to Appeal filed by the TRA and the Consumer Advocate Division in the BellSouth price regulation plan case. On June 15, 1998, the Court entered an order denying the Application for Permission to Appeal, which order had the effect of leaving the decision of the Court of Appeals as the final resolution of the appeal.

from the January 23, 1996 order of the TPSC with respect to BellSouth's price regulation plan application.

### **THE REGULATORY STATUS OF BELL SOUTH**

4. The TPSC adopted a regulatory reform rule for LECs, effective January 10, 1993, Rule 1220-4-2-.55(1)<sup>1</sup>. BellSouth promptly filed an election to come within that Rule. Pursuant to that election and pursuant to an earnings investigation based on 1992 figures, the TPSC entered an order on August 20, 1993 in docket nos. 92-13527 and 93-00311 fixing BellSouth's rate of return at the range between 10.65% to 11.85%, with a mid-point of 11.25%, and on that basis the TPSC fixed BellSouth's rates for the period from January 1, 1993 through December 31, 1995<sup>2</sup>.

5. After the passage of Chapter 408 of the Acts of 1995, which became effective on June 6, 1995, BellSouth filed an application for approval of its price regulation plan. On January 23, 1996 the TPSC entered an order, docket no. 95-02614, finding that a fair rate of return of 10.35% was reasonable. On that basis the TPSC approved BellSouth's price regulation plan application, ordering that BellSouth reduce its rates by \$56.3 million.

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<sup>1</sup> The TPSC first introduced an incentive form of regulation on September 28, 1990, by order and it adopted the three year earnings, review cycle 1990-92. It directed that \$157 million excess earnings be placed in deferred revenue account and be used for prospective rate reduction and service improvements. The TPSC continued its system of incentive regulation for another three year cycle 1993-95, but did it by rule instead of by order.

<sup>2</sup> Within the rule, the TPSC had to establish certain parameters under which each utility was regulated for a certain period of time. For example, it established the length of the review cycle (one, two, three or four years), the fair rate of return, the rate of return sharing points and use of actual or forecasted earnings to measure sharing and excess earnings with customers. The TPSC initiated in July 1995 an investigation to set new parameters for a new review cycle which would begin on January 1, 1996. As was pointed out in AARP's petition, the Court of Appeals stopped the TPSC from continuing that investigation.

6. BellSouth appealed the Commission's order to the Court of Appeals. On October 1, 1997, the Court of Appeals handed down its opinion, concluding:

In summary, we vacate the Commission's January 23, 1996 order and all related earlier orders with regard to BellSouth's application for a price regulation plan. Since the Commission has adopted its staff's conclusion that BellSouth's rate of return reported on its Form PSC-3.01 report for the twelve months ending March 31, 1995 is less than its current authorized rate of return, we remand the case to the Tennessee Regulatory Authority with directions to approve BellSouth's application for a price regulation plan. In light of our conclusion that the Commission did not have the authority to adjust the actual results on BellSouth's Form PSC-3.01 report, we need not consider the remaining issues raised by BellSouth and AT&T. These issues and all other issues raised by the parties are accordingly permitted.

7. BellSouth filed a petition to rehear, asking the Court of Appeals to hold that BellSouth's price regulation plan became effective on March 1, 1996. In denying that petition, the Court held:

Ordering the Authority to grant BellSouth's application for a price regulation plan and to declare that this plan has been in effect since March 1, 1996 would invade the Authority's jurisdiction and would also be inconsistent with our April 3, 1996 stay order. As a result of our stay, BellSouth as continued to operate under the former regulatory statutes rather than the new statutes enacted in 1995. Accordingly, BellSouth has not, as a matter of fact and law, been operating under a price regulation plan since March 1, 1996. It would be error for us to hold at this juncture that it has.

Therefore, it is clear that BellSouth has not been operating under a price regulation plan, and will not be operating under such a plan until such time as the effective date of its price regulation plan has been set by an order which has become final. Instead, BellSouth has been, and continues to be, under the general regulatory statutes governing public utilities within the jurisdiction of the TRA.

8. It is likewise clear that the period of the last order approving BellSouth's rates as just and reasonable expired on December 31, 1995; and from that date either to the effective date of a price regulation plan for BellSouth or to the entry of an order by the TRA fixing just and reasonable rates for BellSouth, there has not been, and will not be, any valid effective determination of the justness and reasonableness of BellSouth's rates.

9. BellSouth elected to come under the regulatory reform rule, 1220-4-2-.55(1). Even though the first three year earnings cycle (1993-95) for the fixing of BellSouth's rates under that rule has expired, BellSouth's election to be regulated under that rule has not expired. Thus, the regulatory reform rule still applies and new parameter can be adopted by the TRA to establish just and reasonable rates under the former regulatory statutes until a price regulation plan becomes effective. However, even if that rule does not apply, BellSouth remains under the general regulatory jurisdiction and powers of the TRA.

10. The purpose of this petition is to ask the TRA to give customers economic justice by exercising its power to fill the regulatory void, or hiatus, between January 1, 1996 and the effective date of BellSouth's price regulation plan. The only means available to the TRA to fill that regulatory gap is by conducting an earnings investigation to fix the level of just and reasonable rates for BellSouth for that period.

11. As a consequence of this regulatory void, BellSouth, as evidenced by its own 3.01 reports, has been charging, collecting and receiving, compensation for its services in this state far in excess of a just and reasonable amount. The TRA has the power and duty to the customers of BellSouth to rectify that windfall.

**THE GENERAL POWERS OF THE TRA TO RECTIFY  
BELLSOUTH'S WINDFALL PROFITS**

12. Public utilities, including BellSouth, are by statute expressly prohibited from charging unreasonable rates for any service rendered in this state; T.C.A. §65-5-204(a); and common carriers or public service companies, including BellSouth, are prohibited from charging, collecting or receiving more than a just and reasonable rate for services in this state; T.C.A. §65-4-122(b).

13. The primary jurisdiction for determining whether the rates or charges of a public utility, a common carrier of intelligence such as a telephone company, or a public service company (all three of which include BellSouth) is in the TRA. The TRA has general supervisory and regulatory power, jurisdiction and control over all public utilities insofar as may be necessary for carrying out the provisions of Chapter 4 of Title 65; T.C.A. §65-4-104. In addition to the powers conferred by Chapter 4, the TRA has all other powers conferred with reference to railroads as provided by Chapter 3 of Title 65, which includes broad investigatory powers; T.C.A. §65-4-105(a). Any doubt as to the existence or extent of a power conferred by Chapters 1, 3 and 5 of Title 65 shall be resolved in favor of the existence of the power, to the end that the TRA may effectively govern and control the public utilities placed under its jurisdiction; T.C.A. §65-4-106. The TRA has the power to investigate, upon its own initiative or upon complaint in writing, "any matter" concerning any public utility within its jurisdiction; T.C.A. §65-4-117. The TRA has the broad power to fix the rates of any public utility within its jurisdiction; T.C.A. §65-5-201. The TRA has the power to issue orders requiring any public

utility within its jurisdiction to show cause why it should not take such action as justified by a preliminary investigation; T.C.A. §65-2-106.

14. Under the decisions of the Tennessee Court of Appeals, the TRA does not have the power to order the reduction of rates retroactively, or to order reparations, or to order refunds to customers except in the limited circumstances provided in T.C.A. §65-5-203. However, the TRA has the power to consider the excessive earnings of a public utility in fixing rates prospectively, and to require the disposition of such excess earnings through prospective rate reductions or through requiring service improvements, through the creation of a deferred revenue account; AARP v. TPSC, 896 S.W.2d 127, 134 (Tenn.App. 1994); Tennessee Cable Television Association v. TPSC, 844 S.W.2d 151, 160 (Tenn.App. 1992); South Central Bell Tel. Co. v. TPSC, 675 S.W.2d 718, 720-21 (Tenn.App. 1984). In the former case, the court held:

The rule speaks of sharing the excess earnings with customers either through prospective rate reductions or through service improvements. In Tennessee Cable TV v PSC, 844 S.W. 2d 151 (Tenn. App. 1992), we held that the Commission had the authority to require a utility to use its excess earnings in that way. We think neither the rule nor the order results in retroactive rate making. American Association of Retired Persons v. Tennessee Public Service Commission, 896 S.W. 2d 127, 134 (Tenn. Ct. App. 1994).

In the above quoted decision, which related to the TPSC's 1993-95 cycle, the court cites its earlier 1992 decision, which related to the 1990-92 cycle, as authority for the proposition that the TPSC may dispose of past excess earnings by giving customers "prospective rate reductions" (TPSC employed this ratemaking procedure under its incentive regulation policy by order for the period 1990-92 and by rule for 1993-95).



*In South Cent. Bell Tel. v. Tennessee Pub. Serv. (Ct. App. 1984) 675 S.W. 2d 718*, the Court of Appeals upheld a \$6.4 customer refund even though it found the TPSC order to be invalid. It stated:

This Court concurs in the finding of the Commission that the Telephone company as derived an excess profit or "windfall" of \$6,418,000 as a result of being granted a tentative rate increase to offset additional depreciation expense, part of which expense, was never incurred. This Court also concurs in the position of the Commission that tax and other savings attributable to the change in depreciation rules should be taken into consideration in making a determination of the net effect of the change in depreciation rules.

If the Telephone Company should be allowed to retain its "windfall profits" because of the invalidity of the Commission order, it would face the possibility of a class action by its patrons for unjust enrichment, or it would be confronted with its retention of excess profit in the consideration of future rate increases. Thus, in the judgment of this Court, a just resolution of the controversy is inevitable and would be only delayed by a ruling favorable to the Telephone Company in this case.

The court gave two reasons for its decision to require BellSouth to go ahead and make the refund. It said BellSouth "would face the possibility of a class action by its patrons for unjust enrichment, or it would be confronted with its retention of excess profit in the consideration of future rate increases." This disposition of excess earnings as prospective rate reductions is the same principle to which the court referred in the above mentioned 1992 and 1994 cases.

15. The "action by its patrons for unjust enrichment" mentioned in the above opinion of the Court of Appeals would have been based on the former provisions of T.C.A. §65-5-111 and 115, which are now codified in T.C.A. §65-4-122(b) and (e). In the South Central Bell case, as the above quotation indicates, the TPSC had determined the existence and amount of the

"windfall profits." The TRA, like the TPSC before it, has the primary jurisdiction to determine the justness and reasonableness of the rates of public utilities under its jurisdiction. Aside from the exercise of the powers described in paragraph 14 above, in order to protect BellSouth from unjustified claims and in order to facilitate the disposition of justified claims, the TRA should exercise its primary jurisdiction to determine the level of just and reasonable rates for BellSouth during the period between January 1, 1996 and the effective date of BellSouth's price regulation plan.

#### **\$351.3 MILLION EXCESSIVE EARNINGS SINCE JANUARY 1, 1996**

16. The Tennessee Legislature in adopting T.C.A. §65-5-209(c) has confirmed the reasonableness of using the rates of return directly from the 3.01 reports as a basis for measuring the earnings of an incumbent local exchange telephone company, such as BellSouth. By comparing the actual rates of return reported on the 3.01 to a fair and reasonable rate of return for BellSouth, it can be seen that BellSouth has reaped a \$351.3 million windfall profit at the expense of its captive customers since January 1, 1996:

	<b>Actual<sup>3</sup> ROR</b>	<b>Fair<sup>4</sup> ROR</b>	<b>Excess<sup>5</sup> Earnings</b>
1996	14.95%	10.35%	\$113.4 Million
1997	18.10%	10.35%	\$191.4 Million
1998 Three months ended March 31	18.90%	10.35%	\$46.5 Million
<b>TOTAL FOR TWO YEARS AND THREE MONTHS</b>			<b>\$351.3 Million</b>

Therefore, there is a reasonable basis for a preliminary finding that for the period January 1, 1996 to March 31, 1998, BellSouth rates were excessive, unjust, unreasonable and allowed BellSouth to collect \$351.3 million in windfall profits from its customers.

17. Although our petition only raises the question of whether rates are just and reasonable under the former regulatory statutes, the tasks of establishing rates under current regulation and price regulation are interrelated. Because of this interrelationship, the TRA will need to coordinate the decision in this case with the price regulation case. If the TRA fails, this could result in double counting the \$212 million excessive earnings on a going forward basis and reduce BellSouth's rates below a reasonable level, or conversely, could require customers to pay \$212 million in excessive rates on a going forward basis, allowing BellSouth to continue to reap windfall profits at the expense of captive customers. The TRA should coordinate these two proceedings to insure that neither BellSouth's customers nor its shareholders are treated unfairly and suffer this perverse result.

<sup>3</sup> See Exhibit 1

<sup>4</sup> 10.35% established by TPSC on January 23, 1996 Price Regulation Order, Docket # 95-02614; 11.25% established by TPSC on August 23, 1993, order under Regulatory Reform Rule, Docket # 92-13527; and 10.40% decided in June 30, 1998, Commission Conference, Docket # 97-01262, BellSouth petition for prices for interconnection (see pages 16-17 of transcript attached as Exhibit 2).

<sup>5</sup> \$113.4 million and \$191.4 million calculation is shown in AARP's January 1998 petition; \$46.5 million =  $18.90\% - 11.35\% \times \$584,543,000 \div .6435 \times 3/12$  (Exhibit 1).

The TRA itself recognized the significance of the impact of the 3.01 on BellSouth's rates when it asked the Supreme Court for guidance in the request for permission to appeal: Which BellSouth 3.01 earnings report should be used to test the affordability of rates existing at June 6, 1995?

The TRA stated in its application:

When BellSouth initially made application to opt under the "price regulation plan" on June 20, 1995, the most recent Form PSC-3.01 Report was March 31, 1995/ At the time of the application, Tenn. Code Ann. Section 65-5-209(c) provided that rates will be deemed affordable under the statute "if the incumbent local telephone exchange company's earned rate of return on its most recent TPSC-3.01 Report as audited by the Commission staff pursuant to subsection (j) is equal to or less than the company's current authorized fair rate of return existing at the time of the company's application." The Commission audited the TPSC-3.01 Report filed on March 31, 1995.

When BellSouth appealed the Commission's order of January 23, 1996, it requested a stay pending appeal of the \$56.3 (Million) rate reduction. Ultimately, the Court of Appeals granted the stay, but as to the entire "price regulation plan." In its order on BellSouth's Petition to Rehear, the Court of Appeals expressly held that "(a)s a result of our stay, BellSouth has continued to operate under the former regulatory statutes rather than under the new statutes enacted in 1995. Accordingly, BellSouth has not, as a matter of fact and law, been operating under a price regulation plan since March 1, 1996 (the date BellSouth requested in its Petition to Rehear)." The Court of Appeals then concluded that "(n)ow it falls upon the Tennessee Regulatory Authority to consider BellSouth's application for a price regulation plan in accordance with Tenn. Code Ann. 65-5-209."

However, the Court of Appeals did not state which 3.01 Report the Authority must now audit. There are two possible choices: (1) the 3.01 Report filed on March 31, 1995, which was the most recent report when BellSouth filed its initial application for a "price regulation plan" on June 20, 1995; or (2) the most recent 3.01 Report filed at the conclusion of this litigation when BellSouth's "price regulation plan" becomes effective. The statute is unclear as to what happens when a stay is granted pending appeal: therefore, the Authority seeks guidance on this issue from

this Court. Application for Permission to Appeal of The Tennessee Regulatory Authority and the Consumer Advocate Division of the Office of the Attorney General, Ct. App. No. 01A01-9602-BC-00066, Supreme Court of Tennessee, pp 16-18, January 20, 1998.

The Supreme Court did not answer this question. If left the TRA with the sole authority and responsibility to exercise its ratemaking expertise and answer this question in way that is not only lawful, but rational and fair to BellSouth's customers and shareholders. AARP believes the TRA must give all parties an opportunity to suggest an appropriate answer to this question through a rule making proceeding; 844 S.W. 2d 151.

#### **THE RELIEF SOUGHT**

18. On the basis of the factual allegations set forth in AARP's original petition, and on the basis of the further facts set forth in paragraphs 16 and 17 above, the TRA should enter an order, pursuant to T.C.A. §65-2-106, requiring BellSouth to show cause why the TRA should not conduct an investigation as to BellSouth's earnings for the period from January 1, 1996 until the effective date of a price regulation plan for BellSouth, determine a reasonable rate of return and a level of just and reasonable rates for BellSouth during that period, and enter an order fixing BellSouth's rates prospectively for the remainder of that period, requiring an appropriate mechanism for disposing of its excess earnings.

19. In the alternative, the TRA should treat AARP's petition, as amended and supplemented hereby, as a complaint, and set the matter for hearing, designate a hearing officer

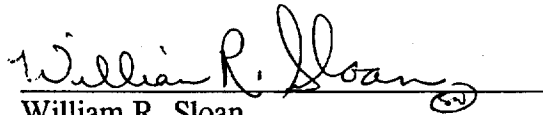
to hold a pre-hearing conference for the purpose of defining the issues, setting a schedule for the filing of pre-filed testimony and briefs and making recommendations for the disposition of any preliminary matters; and

20. to institute a rule making proceeding to determine the appropriate 3.01 report to use with the implementation of a price regulation plan.

## **PRAYERS**

The premises considered, the American Association of Retired Persons prays that:

1. The TRA enter an order, pursuant to T.C.A. §65-2-106, requiring BellSouth to show cause why the TRA should not conduct an investigation as to BellSouth's earnings for the period from January 1, 1996 until the effective date of a price regulation plan for BellSouth, determine a reasonable rate of return and a level of just and reasonable rates for BellSouth during that period, and enter an order fixing BellSouth's rates prospectively for the remainder of that period, requiring an appropriate mechanism for the disposition of its excessive earnings to its customers; or
2. In the alternative, the TRA should treat the original petition filed by AARP as hereby amended and supplemented, as a complaint, and set the matter for hearing, designate a hearing officer to hold a pre-hearing conference for the purpose of defining the issues, setting a schedule for the filing of pre-filed testimony and briefs and making recommendations for the disposition of any preliminary matters; and
3. AARP have such other, further and general relief as the justice of its cause may entitle it to receive.



William R. Sloan  
199 IVY Brook Drive  
Bethpate, TN 37022

Kenneth Atkins, Esq.  
404 East College Street  
Dickson, TN 37055

Attorneys for American Association of Retired Persons

CERTIFICATE OF SERVICE

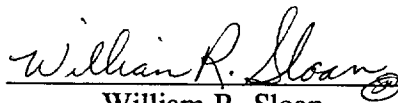
I hereby certify that on July 6, 1998, a copy of the foregoing document was served on the parties of record, via U. S. Mail, postage pre-paid, addressed as follows:

Guy M. Hicks  
333 Commerce Street, Suite 2101  
Nashville, TN 37201-3300

William J. Ellenberg, II  
Bennett L. Ross  
675 W. Peachtree Street, N.E.  
Suite 4300  
Atlanta, GA 30309

Vincent Williams  
Office of the Attorney General  
Consumer Advocate Division  
425 5th Avenue, North  
Nashville, TN 37243

Dennis McNamee  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0500

  
\_\_\_\_\_  
William R. Sloan



	Average Monthly Balance	Average YTD	Average for 12 MTD
<b>Additions:</b>			
1 Plant In Service	3,444,633	3,356,704	3,356,704
2 Plant Under Construction	12,866	15,531	15,531
3 Property Held For Future Use	0	0	0
4 Materials & Supplies	11,535	15,022	15,022
Other Additions:			
5 Cash Requirements	6,690	7,181	7,181
6 MemoryCall	10,161	8,889	8,889
7 Yellow Page Imputation	21,766	23,039	23,039
8 Total Additions	3,507,651	3,426,366	3,426,366
<b>Deductions:</b>			
9 Accumulated Depreciation	1,552,558	1,474,490	1,474,490
10 Accumulated Deferred Income Taxes	254,865	249,087	249,087
11 Unamortized Investment Credit - Pre 1971	17	11	11
12 Customer Deposits	2,533	2,620	2,620
Other Deductions:			
13 Cash Advanced Thru Operations	123,935	113,897	113,897
14 Average Deferred Liability Balance	0	0	0
15 Total Deductions	1,933,907	1,840,105	1,840,105
16 Rate Base	1,573,744	1,586,261	1,586,261
 17 Net Operating Income (NOI)	 23,909	 219,884	 219,884
Adjustments to NOI:			
18 Allowance Funds	77	1,056	1,056
19 Less: Other Expenses	105	1,036	1,036
20 Less: Interest on Customer Deposits	14	171	171
21 Lobbying Expense Adjustment - Net #	6	76	76
22 Federal Income Tax Adjustment	35	346	346
23 Other Operating Income & Expense	108	7,075	7,075
24 Affiliated Charges	45	538	538
25 MemoryCall	(230)	786	786
26 Yellow Page Imputation	(526)	8,661	8,661
27 Less: Interest Expense on Deferred Liab (Net)	0	0	0
28 Adjusted Net Operating Income	23,305	237,216	237,216
29 Rate of Return	17.77%	14.95%	14.95%
30 Average BellSouth Telecommunications, Inc. Debt Ratio	41.49%	N/A	41.89%
31 Average BellSouth Telecommunications, Inc. Debt Cost	6.42%	N/A	6.41%

CONTINUING SURVEILLANCE CONSIDERATIONS. Estimate the effect on net operating income of very significant known changes occurring within the period covered by the report which are not fully reflected in the revenue and expense amounts shown in the report.

(\$ in Millions)

Adjust. to Income for Effect of Known Changes

Month  
.7M

12  
Months-to-Date  
-1.7M

# As estimated by Commission Staff

SUPPLEMENTAL FINANCIAL DATA TO PSC 3.01  
FOR THE MONTH ENDED December, 199

Line #	Average Monthly Balance	Average YTD	Average for 12 MTD
Additions:			
1 Plant In Service	3,594,388	3,520,415	3,520,415
2 Plant Under Construction	20,488	21,217	21,217
3 Property Held For Future Use	0	2	2
4 Materials & Supplies	11,435	13,465	13,465
Other Additions:			
5 Cash Requirements	7,108	7,240	7,240
6 MemoryCall	10,810	10,903	10,903
7 Yellow Page Imputation	22,320	22,413	22,413
8 Total Additions	3,666,550	3,595,655	3,595,655
Deductions:			
9 Accumulated Depreciation	1,693,094	1,632,211	1,632,211
10 Accumulated Deferred Income Taxes	264,890	247,641	247,641
11 Unamortized Investment Credit - Pre 1971	10	10	10
12 Customer Deposits	2,647	2,691	2,691
Other Deductions:			
13 Cash Advanced Thru Operations	121,383	123,506	123,506
14 Average Deferred Liability Balance	0	0	0
15 Total Deductions	2,082,024	2,006,060	2,006,060
16 Rate Base	1,584,526	1,589,596	1,589,596
17 Net Operating Income (NOI)	14,486	274,879	274,879
Adjustments to NOI:			
18 Allowance Funds	98	1,189	1,189
19 Less: Other Expenses	334	1,189	1,189
20 Less: Interest on Customer Deposits	14	191	191
21 Lobbying Expense Adjustment - Net #	6	76	76
22 Federal Income Tax Adjustment	17	530	530
23 Other Operating Income & Expense	108	3,191	3,191
24 Affiliated Charges	45	538	538
25 MemoryCall	19	(460)	(460)
26 Yellow Page Imputation	(94)	9,124	9,124
27 Less: Interest Expense on Deferred Liab (Net)	0	0	0
28 Adjusted Net Operating Income	14,336	287,687	287,687
29 Rate of Return	10.86%	18.10%	18.10%
30 Average BellSouth Telecommunications, Inc. Debt Ratio	41.87%	N/A	41.21%
31 Average BellSouth Telecommunications, Inc. Debt Cost	6.42%	N/A	6.44%

CONTINUING SURVEILLANCE CONSIDERATIONS. Estimate the effect on net operating income of very significant known changes occurring within the period covered by the report which are not fully reflected in the revenue and expense amounts shown in the report.

(\$ in Millions)

	Month	12 Months-to-Date
Adjust. to Income for Effect of Known Changes	-3.0M	-5.5M

# As estimated by Commission Staff

Line #	Average Monthly Balance	Average YTD	Average for 12 MTD
Additions:			
1 Plant In Service	3,640,351	3,632,581	3,560,870
2 Plant Under Construction	22,596	22,502	22,717
3 Property Held For Future Use	0	0	0
4 Materials & Supplies	9,775	10,040	12,839
Other Additions:			
5 Cash Requirements	7,293	7,540	7,260
6 MemoryCall	11,345	10,987	11,014
7 Yellow Page Imputation	21,567	22,109	22,338
8 Total Additions	3,712,928	3,705,759	3,637,038
Deductions:			
9 Accumulated Depreciation	1,742,559	1,729,892	1,669,151
10 Accumulated Deferred Income Taxes	270,609	272,811	253,162
11 Unamortized Investment Credit - Pre 1971	10	10	10
12 Customer Deposits	2,720	2,679	2,716
Other Deductions:			
13 Cash Advanced Thru Operations	112,703	115,824	121,755
14 Average Deferred Liability Balance	0	0	0
15 Total Deductions	2,128,601	2,121,216	2,046,793
16 Rate Base	1,584,328	1,584,543	1,590,245
17 Net Operating Income (NOI)	34,621	72,569	266,529
Adjustments to NOI:			
18 Allowance Funds	92	293	1,269
19 Less: Other Expenses	250	450	1,452
20 Less: Interest on Customer Deposits	15	42	192
21 Lobbying Expense Adjustment - Net #	6	19	76
22 Federal Income Tax Adjustment	34	120	518
23 Other Operating Income & Expense	109	337	3,328
24 Affiliated Charges	45	135	538
25 MemoryCall	22	(244)	(395)
26 Yellow Page Imputation	598	2,148	8,407
27 Less: Interest Expense on Deferred Liab (Net)	0	0	0
28 Adjusted Net Operating Income	35,262	74,883	278,627
29 Rate of Return	26.71%	18.90%	17.52%
30 Average BellSouth Telecommunications, Inc. Debt Ratio	41.45%	N/A	41.39%
31 Average BellSouth Telecommunications, Inc. Debt Cost	6.31%	N/A	6.42%

CONTINUING SURVEILLANCE CONSIDERATIONS. Estimate the effect on net operating income of very significant known changes occurring within the period covered by the report which are not fully reflected in the revenue and expense amounts shown in the report.

(\$ in Millions)

Adjust. to Income for Effect of Known Changes

Month  
-9M

12  
Months-to-Date  
7.5M

# As estimated by Commission Staff

1 rates that were set in 1993 in the 1993 three-way  
2 meeting and utilized the same projection life,  
3 average remaining life, and future net salvage should  
4 be used in this proceeding. The depreciation lives  
5 used in the BellSouth cost study were determined by  
6 calculating the average of the proposed lives for  
7 BellSouth's nine-state region.

8                   The Tennessee-specific rates were  
9 set based upon the plant located in Tennessee and  
10 should be used in this docket, in my opinion, since  
11 they are most closely related to the Tennessee  
12 plant. Therefore, I would move that the TELRIC and  
13 Hatfield Models should use Tennessee-specific  
14 depreciation lives salvage values and other inputs  
15 used in calculating the depreciation rates  
16 established by the TPSC in 1993.

17                   DIRECTOR KYLE: Second.

18                   CHAIRMAN GREER: Make it  
19 unanimous.

20                   Issue 6, what is the cost -- what  
21 cost of capital is appropriate for setting permanent  
22 prices?

23                   The parties stated that the  
24 choice of comparison group and the choice of model  
25 are separate choices. Therefore, using the AT&T

1 comparison group and BellSouth's discounted cash flow  
2 model, yields a cost of equity of 12.46 percent.  
3 Ideally, the TRA should adopt forward-looking  
4 estimates of the cost of capital for a wholesale UNE  
5 leasing business serving BellSouth's Tennessee  
6 service territory. On this basis, Billingsley's  
7 7.30 percent cost of debt is slightly more  
8 forward-looking than the Cornell-Hirshleifer's  
9 recommendation.

10 Therefore, I move that the  
11 Authority adopt a 10.4 percent overall cost of  
12 capital and a 12.46 percent cost of equity for use in  
13 the models.

14 DIRECTOR MALONE: Second.

15 DIRECTOR KYLE: I'll vote yes.

16 CHAIRMAN GREER: Issue 7, how  
17 should network maintenance expense be calculated?

18 I'll take another run at it. All  
19 of the parties agree that productivity should be  
20 reflected in the forward-looking cost of the UNEs.  
21 The question then is what is a reasonable level of  
22 productivity to include? Using the projected  
23 plant-specific expense for 1999 as a reasonable  
24 forward-looking period for attempting to accurately  
25 estimate productivity in the future, AT&T proposes